Dutch Horizontal Tax Monitoring: will others follow where this historic leader is heading?

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Large business taxpayers arguably fall into two broad camps, both of whom act with the best of intentions: the first (and largest) camp is comprised of taxpayers who carry out their business, file their tax returns and generally wait to see what happens in terms of incoming inquiries and scrutiny, hoping for no further interventions from the reviewing tax authority. There is nothing wrong with this.

The second group – arguably more inquisitive, proactive and generally keener to keep their finger closely on the pulse of global tax trends and developments – will often look to assess and take advantage of new and innovative tools and programs that may deliver higher levels of tax certainty sooner. They also understand that such programs may not be suitable for every taxpayer, but where a good fit is found, positive results can be achieved. Perhaps even more importantly, they further understand that a new program introduced in one jurisdiction can quickly catch the eye of tax administrators elsewhere, with programs that deliver results for a revenue body rapidly picked up and replicated.

This latter camp has probably already studied recent changes to the Dutch Horizontal Tax Monitoring (HTM) program, first introduced in 2005, and recently redesigned and revamped as the result of a comprehensive review by the Dutch tax authorities ("Belastingdienst"). An early and important example of programs designed to enhance tax certainty, HTM is well-regarded by many other tax authorities, and while not a de-facto global standard by any stretch, it has historically exerted a strong influence on the design of similar programs in Russia, Singapore, South Korea and Poland – and more recently, Brazil - among many others.

Its redesign may well continue to influence similar programs in other countries; but perhaps more importantly still, it may also provide wider clues as to the changing nature of the relationship between large business taxpayers and taxing authorities.

Co-operative compliance: a short history

The first country to introduce a formal co-operative compliance program (the broad category under which HTM sits) was Australia in 2001. By 2008, several other countries, including South Africa, Singapore, the US, UK and the Netherlands had adopted similar co-operative compliance programs.

Given the magnitude and resultant effect of this movement, the Organisation for Economic Co-operation and Development's (OECD) Forum on Tax Administration[1] (FTA) in 2008 published a report – the *Study into the Role of Tax Intermediaries*[2] – in which it encouraged revenue bodies to establish relationships based upon mutual trust and cooperation with large business taxpayers, as by doing so they could better filter lower risk taxpayers from higher risk companies, targeting their resources more effectively.

This OECD's first report was followed in 2013 by a second, *Co-operative Compliance: A Framework – From Enhanced Relationship to Co-operative Compliance*[3] in which early program successes were shared. As can be noted from the report's title, the FTA at that point also took the opportunity to undertake a rebranding exercise – moving from "enhanced relationships" to "co-operative compliance," a reflection of their concern (and that of individual countries) that the earlier description could potentially be misconstrued.

The five-year period between reports was characterized by a relatively slow but steady increase in the number of countries implementing co-operative compliance programs and more locally, robust adoption of the HTM program by Dutch companies. Indeed, the widespread use of HTM by the time of the first BEPS recommendations in 2015 is remarkable, with almost 2,000 individual covenants (the formal agreement between the taxpayer and the Dutch tax authority) concluded by large companies[4], typically multinationals. Moreover, more than 100,000 small and medium enterprises (SMEs) had also signed a covenant by that point, concluding their certification via a "qualified intermediary," usually an accountancy company.

Co-operative compliance: a short definition

Co-operative compliance is an extension of a risk-based approach that tax authorities may take to assuring tax compliance. It can be described as a voluntarily, enriched relationship between a revenue body and a business taxpayer, based upon mutual increased transparency, co-operation and collaboration. Its intention is to change the nature of the dialogue – indeed, change the overall relationship – between revenue body and taxpayer, attempting to foster a new level of trust that the revenue body feels in turn justifies reduced interventions (i.e., audits) in the tax compliance process. In some, but not all, programs, the taxpayer may receive various administrative incentives in return for participation, including, for example, a dedicated point of contact within the tax authority (i.e., a relationship manager), access to specialized programs or expedited tax refunds. In essence, the Dutch program replaces top-down, post-filing review and scrutiny – "vertical" monitoring – with the real-time, collaborative "horizontal" monitoring of participating companies.

The objective, of course, is to come to a situation that represents a win-win solution for both parties.

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[1] The Forum on Tax Administration (FTA), created in 2002, is a unique body bringing together Commissioners from 53 advanced and emerging tax administrations from across the globe, including all OECD and G20 members.

[2] *Study into the role of tax intermediaries*, OECD, 2008: https://www.oecd.org/tax/administration/39882938.pdf

[3] Co-operative Compliance: A Framework – From Enhanced Relationship to Co-operative Compliance, OECD, 2013: https://www.oecd.org/publications/co-operative-compliance-a-framework-9789264200852-en.htm

[4] 17de halfjaarrapportage, Belastingdienst dd 13-04-2016, p.65.

This involves incentivizing taxpayers to be compliant, while simultaneously allowing the revenue body to "resource-to-risk," focusing their limited resources more tightly on a smaller group of potentially less-compliant taxpayers, and, they hope, raising greater tax revenues with the fewer highly skilled tax auditing (and litigation) resources they have available.

Mechanics

Under such programs, which exist today in dozens of countries, with new programs continually arising, the taxpayer agrees to notify the tax authority (in the case of HTM, a dedicated point of contact, called a "client coordinator") proactively and regularly of any issues that may represent a possible or significant tax risk, and to immediately disclose all facts and circumstances regarding such issues. The ideal objective is to gain more immediate certainty of the tax authority's potential treatment of such issues, removing the possibility of a later audit or litigation. Such disclosures typically occur in real- or near-real-time, with the taxpayer and revenue body agreeing to review such circumstances without delay, agreeing upon the best way forward and putting the issue to rest as soon as possible.

Furthermore, and generally in advance of such a program commencing, taxpayers are typically expected to give the revenue body information regarding their overall Tax Control Framework (TCF) system or the approach they use to identify and then manage tax risks. This is done on the premise that if the revenue body is satisfied with the taxpayer's design, testing and adherence to such an approach, there should be less or even no need for the revenue body to carry out traditional post-filing auditing of the transactions and tax positions contained in the final tax return. In effect, based upon an understanding of the control system used and ongoing disclosure of potential risks encountered, the revenue body feels more confident in applying a "lighter touch" supervision regime.

Depending on their classification, companies participating in the Dutch program are required to sign and maintain a "covenant" between themselves and Dutch tax authority. The covenant is also a typical similar element of programs elsewhere (though it usually has a different name), is a board-approved agreement within which the mechanics of HTM and the expectations of the Dutch tax authority are set out.

While each tax authority running such a program will have specific requirements, those as set out in the Dutch HTM program – at least, ahead of its 2020 revision – can be viewed as somewhat common and include:

- In the case of large business taxpayers, the covenant applies to the entire group, or at least those entities engaged in core business activity, and over which Dutch management exerts control.
- Both parties (tax administration and taxpayer) articulate their mutual desire to sustain an effective and efficient working relationship based upon (in the words of the HTM guidance) "mutual trust, understanding and transparency."

- The rights of participating taxpayers remain unchanged, and those participating in the program should not experience outcomes that are either more or less favorable than those experienced by taxpayers outside the program.
- The taxpayer is required to maintain a robust system of internal and external tax risk controls known as a TCF. The TCF aims to provide the enterprise with enhanced tax risk identification and risk management capabilities. The supervision of the Dutch tax authority within the context of HTM, meanwhile, is customized (i.e., increased or decreased) based upon its perception of the quality of and adherence to the TCF.
- The taxpayer must commit to settling any tax debts in a timely manner, while the tax administration likewise commits to the timely payment of any tax refunds.
- Both parties must agree to support a level of resources and a day-to-day approach to their relationship that facilitates the real-time disclosure and review of any transactions or tax positions of which the taxpayer is uncertain of resulting treatment by the tax authority. Further, the taxpayer agrees to fully understand the potential legal consequences of positions taken in advance, while the Dutch tax authority undertakes to review, discuss, and, if suitable, grant tax certainty on the positions taken by the taxpayer. If granted, such certainty is legally binding.
- Where a position relates to a cross-border transaction, the discussion and review process will typically take longer than for a domestic issue, and in fact utilizes a separate tax authority process.
- Should a transaction or tax position receive negative judgment from the tax authority, the taxpayer may choose to include it within their tax return, but it must be marked as such. The taxpayer is furthermore permitted to litigate such positions should the tax authority ultimately disagree with the position taken.

Prior to the 2020 HTM design changes, covenants were concluded for an unlimited period of time, with either party able to terminate the covenant via written instruction. Periodic evaluations of the covenant were undertaken by the Dutch tax authority; in theory once per year for the very largest taxpayers and once every two years for the next segment of taxpayers.

The benefits of participation in programs such as HTM have long been the source of debate, with many commentators arguing that MNCs should receive a higher level of benefit in return for their transparency and disclosure as part of the program. As far as HTM goes, participation in the program and a positive outcome does not result in a formal lower risk rating for the company (as may be the case in some jurisdictions). That said, companies that are able to demonstrate that their TCF operates effectively, participate in HTM in good faith and have an absence of high-risk positions may experience a reduced number of high-impact compliance interventions (i.e., tax audits) or even no audits at all. This is generally described in guidance published by the Dutch tax authority.

The 2020 changes to HTM

As can often be the case with any complex program (and particularly one like HTM that deals with vastly expanded value and supply chains, digitalization of business models and cross-border tax rules that are widely viewed as no longer being completely fit for purpose) strains emerged. After a review of the program, in 2017 the Dutch tax authority released the findings of their *Report on Investigation of Large Companies (“Rapport Onderzoek Grote Ondernemingen”).*

One key finding was that the number of adjustments to post-filing tax assessments made by the Dutch tax authority, as well as the average amount of tax generated by said adjustments, was broadly the same for companies *in* the HTM program as it was for those *outside of it*. In essence, this raised an important point: was HTM delivering its intended results?

Were this the only finding of note, HTM may have remained unchanged. In fact, though, the report highlighted several other concerns:

- There was no distinct difference between those companies in the HTM program and those outside it in relation to the timely filing of tax returns or on-time payment of taxes owed.
- While Dutch-headquartered companies were perceived as being active participants in the program (which at the time was 100% voluntary in nature), many other MNCs, particularly those headquartered in North America, chose to remain outside the program.
- The generally high demand among Dutch companies to participate in the program was creating a significant drain on the tax authority’s resources, who had to generate and manage comprehensive, customized workplans for each participating company. In particular, the day-to-day monitoring and dealing with the review and discussion of ongoing transactions was viewed as taking up a high level of tax authority resources.
- There remained uncertainty as to whether companies participating voluntarily in the program were really demonstrating true transparency.

Responding to these and other challenges, the Dutch authority in February 2020 published new HTM guidance, since updated[5], which had immediate practical effect. While remaining true to the core principles of mutual trust, transparency and real-time disclosure, the guidance set out several fundamental shifts that change the nature of the program quite dramatically. Among other things:

- The program became mandatory for the top 100 largest and most complex organizations operating in the Netherlands (as selected by the Dutch tax authorities), as well as for the 30 largest and most complex non-profit or public organizations and pension funds. There is no covenant for these companies, and each is instead subject to a customized supervision approach drafted by the Dutch tax authority and agreed in collaboration with the company, with some room for negotiation, and outlined in an individual supervision plan. That plan is reviewed and revised on a rolling basis, with a more formal evaluation occurring every three years.

[5] *Leidraad Toezicht Grote ondernemingen - Versie December 2021:*
https://download.belastingdienst.nl/belastingdienst/docs/leidraad_toezicht_grote_ondernemingen_dv4231z3fd.pdf

- For enterprises that meet two out of three criteria (that they have total assets of more than €20 million, total turnover of more than €40 million, and more than 250 employees) for two consecutive years, the program remained voluntary in nature, continuing to be based upon the content of a covenant, itself now valid for three years. The supervision approach of the Dutch tax authorities for each company in this segment (believed to number roughly 900) is outlined in a strategic treatment plan. This treatment plan is shared with the company when the covenant is signed and then once every three years. Treatment plans are standard in their set up but will be customized in content depending on the factual situation (including the nature of the key risks and the monitoring outcomes) of the company. For the covenant there is no space for negotiation. These companies will also experience increased interest of the Dutch Tax Authorities in their internal tax control measures compared to the prior version of HTM. The practical ways of working between the Dutch Tax Authorities and the company are typically agreed separately.
- SMEs (defined in the Dutch civil code referring to those companies with more than €6 million of assets, total turnover of more than €12 million, and more than 50 employees) may continue to participate, but only after they conclude a covenant with a participating tax advisory firm. Under such an arrangement, the covenant will be valid for a period of five years.
- Last, and mainly impacting the first two tiers of participating companies, the scrutiny of certain cross-border tax issues has been significantly tightened. The Dutch tax authority has created a list of the most commonly experienced cross-border tax risks, where transfer pricing issues appear with regularity and companies with such risks can readily expect greater levels of scrutiny.

The Dutch tax authorities also publish[6] an anonymized summary of “good practices.” These good practices, which address examples for each principle of tax control based on real cases, will be published on a regular basis, and are designed to not only help companies design their own framework approach to tax risk management, but to also identify common issues that may in future cause heightened scrutiny, in the hope that such issues may be avoided or at least mitigated by companies in future.

Requirements for participation

As part of their revamp of HTM the Dutch tax authorities have developed a set of six criteria designed to help enterprises in the second tier of taxpayers (i.e., outside the 100 largest companies) test their suitability and readiness to enter HTM. These criteria are contained within a self-assessment, itself designed to deliver an action plan of issues that must first be addressed, should the company wish to enter into a covenant. The six criteria can be summarized as follows:

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[6] Belastingdienst - Good Practices Fiscale beheersing - versie december 2021

1. **The organization must be willing to be transparent:** The Dutch tax authority expects the organization to be fully transparent with regards to its tax strategy and tax controls. It should be clear that the organization is willing to be communicative, informative on a timely basis, and willing to openly discuss relevant tax risks or complex transaction in real time.
2. **The organization must be willing to maintain a professional working relationship that enables horizontal monitoring to occur:** Management must commit to ensuring the participating tax department has not only the resources to meet HTM's ongoing requirements, but that they will be mandated to do so.
3. **The organization must have a documented tax strategy:** That tax strategy should, at minimum, contain the following elements:
   - The mission and/or vision of the organization and related strategic decisions therein
   - The attitude of the company's board toward the tax risks and related consequences of achieving the strategy
   - The tax policy of the organization, including the organization's approach to tax planning
   - Any tax performance indicators that the company will utilize in pursuing their strategy
   - The type of relationship the organization wishes to have with the Dutch tax authorities
4. **The organization must perform a tax risk analysis which, at minimum, assesses the key tax risks:** The organization must perform a comprehensive tax risk analysis (i.e., a snapshot) and share it with the Dutch tax authority in advance of entering the program. The outcomes document should include information on how each identified risk will be mitigated. The Dutch tax authority, in return, will provide a response detailing their perspective regarding the key tax risks. The tax authority may also put forward new tax risks.
5. **The organization must have working procedures in place regarding their ongoing monitoring of key tax risks:** The organization must make clear in their application exactly how tax risks will be identified, prioritized and managed on an ongoing basis. This does not represent the explicit need for a TCF, and instead focuses on outcomes (i.e., that the TCF performs as intended). In this regard, the guidance of the Dutch tax authority could be improved, perhaps making it more explicitly clear that companies should indeed have a TCF.
6. **The organization must assure that the quality of tax data received from third parties is accurate.**

Finally, the self-assessment process requires the following additional information to be submitted with the organization's application:

- A general description of the organization, including an overview of the entities covered by the covenant and their activities, as well as the organization's tax activities
- An overview of the tax department, including who the key tax officers are, how roles and responsibilities are divided among them, what tax expertise they have and how they keep this up to date

- Whether (and which) tax matters are outsourced to external parties and how quality is assured
- An overview of current advance pricing agreements (APAs), tax rulings and settlement agreements
- An action plan prepared and approved by management outlining the steps needed to start meeting the aforementioned six criteria

Application procedure and timing

As a voluntary program (outside of the 100 largest taxpayers and 30 largest and most complex non-profit or public organizations and pension funds) each taxpayer must apply for admission to the program. As a first step, the taxpayer and the Dutch tax authorities will have a conversation, exploring expectations and discussing next steps. The aim is to have the conversation at the highest management level of the organization – i.e., the Board of Directors.

After such conversation has occurred, the self-assessment tool is completed, and the results are shared with the Dutch tax authorities for further review. Organizations that did *not* have a covenant in place on 1 January 2020 must perform a full self-assessment to enter an HTM. Organizations that *did* have a covenant on 1 January 2020 must also check if they comply with the six criteria listed above. If the organization does not comply with one or more criteria, it must compile an action plan that ensures it is able to comply by 31 December 2022 at the latest. This period can be extended by one year, under the condition that by 31 December 2022 an action plan is prepared that ensures compliance occurs with the requirements by year-end 2023.

Key observations

The changes to the HTM program are important in and of themselves, especially to those either participating in or interested in applying to the program. Perhaps even more important are how some of the changes are indicative of an ongoing, wider shift in the relationship between taxpayer and taxing authority generally. Much like how automatic taxpayer information exchange has upended information asymmetry between the two parties, ongoing changes to tax compliance programs are indicative of a far more fundamental change, one within which greater levels of responsibility are being assigned to and expected of taxpayers. Again, the objective here is to make more efficient use of tax authority resources, and to try and effect behavioral change, an objective that such programs share with the two base erosion and profit shifting (BEPS) projects.

In essence, and aligned with programs such as BEPS Action 12 (on mandatory disclosure) and the EU Mandatory Disclosure Regime (MDR), the onus is rapidly moving to taxpayers needing to prove that they are worthy of trust. Not only does co-operative compliance *generally* support this shift, but the increasingly mandatory nature of some parts of co-operative compliance programs (usually for the very largest companies) arguably moves such programs out of the “co-operative” category and more firmly

into mandatory compliance assurance program territory. This shift should not be overlooked by those in charge of taxes for MNCs, where similar moves in Australia and Germany may have already caught attention.

A further observation is how quickly these programs are being made available (though not mandatorily so) to businesses of smaller sizes. Gone are the days of co-operative compliance being the preserve of the very largest MNCs. Today, many programs cater to companies of all sizes, ushering all businesses toward changed compliance behavior.

All things considered, changes to the Dutch HTM program hold as much importance globally as they do locally. And as we pass through 2022, taxpayers should be on the watch for similar developments elsewhere. This author would look East in the short term – to Malaysia and Singapore, where similar developments are already afoot.

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